Varun Beverages Limited

Q4 & CY2018 Earnings Conference Call Transcript
February 20, 2019

Moderator: Good day, ladies and gentlemen and a very warm welcome to the earnings conference call of Varun Beverages Limited. As a reminder, all participants' lines will be in the listen only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Anoop Poojari from CDR India. Thank you and over to you, sir.

Anoop Poojari: Thank you. Good evening, everyone, and thank you for joining us on Varun Beverages Q4 & CY2018 Earnings Conference Call. We have with us Mr. Ravi Jaipuria – Chairman of the Company; Mr. Varun Jaipuria – Wholetime Director; Mr. Raj Gandhi – Group CFO and Wholetime Director; Mr. Kapil Agarwal – CEO & Wholetime Director and Mr. Kamlesh Jain – CFO and Wholetime Director of the company.

We will initiate the call with opening remarks from the management, following which we will have the forum open for question-and-answer session.

Before we begin, I would like to state that some statements made in today's call may be forward-looking in nature and a detail statement in this regard is available in the 'Results Presentation' shared with you earlier. I would now request Mr. Ravi Jaipuria to make his opening remarks.

Ravi Jaipuria: Good evening, everyone, and thank you for joining us on the call. I hope all of you had the opportunity to go through our results presentation which provides details of our operational and financial performance for the fourth quarter and year-ended 31st December 2018.

We have ended the year on a strong note, delivering a robust top line growth of 49% and EBITDA growth of 47% in Q4. Organic volume growth in India was robust at 28% on the back of a strong festive season. The trend for the full year has also been encouraging as we have reverted to our historical growth trends with revenue growth of 28%. This was led by robust volume growth of 21.9% and value growth of ~5.6% driven by the introduction of higher realization products. Our India business has delivered organic volume growth of 13.3% for 2018. PAT increased by 40% YoY driven by strong volumes in India as well as Zimbabwe. We have recorded 15 million cases in only 10-months since we commenced operations in Zimbabwe and already captured 35% market share there. We have also seen some stabilization in our Sri Lanka operations with the launch of several new variants and the reversion in excise duty.

Further, we are excited to share that VBL and PepsiCo India are further strengthening their close to three decades long partnership. We recently concluded the acquisition of PepsiCo India previously franchised territories of Maharashtra (14 districts), parts of Karnataka (13 districts) and parts of Madhya Pradesh (3 districts). We have also entered into a binding agreement with PepsiCo India to acquire franchise rights in south and west regions from PepsiCo for a national bottling sales and distribution footprint in seven states – Gujarat, part of Maharashtra, parts of Karnataka, parts of Telangana, parts of Andhra Pradesh, Kerala and Tamil Nadu and five union territories, Daman & Diu, Dadra and Nagar Haveli, Andaman and Nicobar Islands, Lakshadweep and Pondicherry. Subject to receipt of necessary statutory approvals, this is part of the strategy to consolidate our presence in contiguous territories and garner market share. We believe that these are high potential markets which offer long-term sustainable growth opportunities.

Acquisitions have been a key component of the growth strategy for many years and substantially accelerated our revenue growth rate, profitability and cash flow. We are confident that this development will help us acquire greater scale operational productivity and efficiency, leading to higher revenues and profitable growth. The acquisition of these territories should lead to better asset usage as the seasonality in these regions is relatively lower. This is a welcome force multiplier to our efforts to aggressively expand our beverage business across geographies and consolidate our dominant position as a key player in the beverage industry. Upon completion of these acquisitions, VBL will account for 80%+ of PepsiCo India's beverage sale volume in India from 51% earlier, and expand our presence to 27 states and 7 union territories. The acquisitions have been made in line with the guidelines that have been laid out by the board.

As we enter the new year we are on a strong footing. We have created a stronger business and several value accretive acquisitions, continuously enhanced our product portfolio and are well poised to capitalize on the significant growth potential in our target markets for many years to come, on the back of our end-to-end execution capability and presence across entire beverage value chain.

I would now invite Mr. Gandhi to provide highlights of the operational and financial performance. Thank you very much.

Raj Gandhi: Thank you, Mr. Chairman. Good evening and warm welcome to everyone for joining the investor call. Let me provide an overview of the financial performance for the fourth quarter and year-ended 31st December 2018. As you are aware, our business is seasonal and best monitored on an annual basis. Q4 is a seasonally soft quarter for us; however with the shift in the festive season, this year Q4 we have recorded a strong performance. Revenue from operations adjusted for excise, GST, grew 49% YoY in Q4 2018 to Rs.7,856 million while EBITDA grew 46.6% YoY to Rs.478 million. Our performance for the year has also been strong with revenue growth of 27.5% YoY in 2018 to Rs.51,052.5 million. Total sales volume were up 21.9% YoY at 340 million unit cases in 2018 as compared to 278.8 million unit cases in 2017.

Further, the introduction of higher realization products, MRP increase in select SKUs and reclassification of freight cost instead of netting off from revenue, as was being done till last year, have resulted in 5.6% value growth during this year. India business saw traction recording strong organic volume growth of 13.3% in 2018 while we recorded organic volume growth of 9.6% on a consolidated basis.

Gross margins expanded 126 basis points YoY to 56%. EBITDA increased by 20.4% to Rs.10,065.9 million in 2018 from Rs.8,357.57 million in 2017. Underlying

EBITDA margins have improved in existing as well as recently acquired territories on the back of operational efficiencies, increase in organic volumes and consolidation of contiguous territories. However, blended margins reduced by 116 basis points YoY to 19.7% due to sub-optimal volume/margin in acquired territories and contribution from the Tropicana Juice portfolio. At present we only have supply and distribution arrangement and we are not manufacturing this product. Depreciation has increased during the year on account of inorganic expansion. Finance cost has remained stagnant even after considerable organic and inorganic expansion during 2018. The robust volume growth in India and strong volumes in Zimbabwe have resulted in 40.1% YoY increase in profit after tax to Rs.2,998.6 million in 2018 from Rs.2,140.6 million in 2017.

Net debt stood at Rs 26,715 million as on 31st December 2018 as against Rs 25,572 million as on 31st December 2017. Net debt as on 31st December '18 includes a debt of Rs.4,000 million availed for Pathankot facility which we expect to operationalize in March 2019. This is the capex ahead for the next year. Working capital days have come down to 26-days as against 30-days during 2018 on account of efficient working capital management, and even after consolidation of five new sub-territories in India during the period. Net capex for 2018 stood at Rs.7,915.2 million. In addition, capital work-in progress for Pathankot plant is Rs.3,523.6 million.

We have furthered our strategic intent to expand into contiguous territories in India when an opportunity has presented. As noted by Mr. Chairman, we have recently entered into a binding agreement with PepsiCo India to acquire franchise rights in south and west regions from PepsiCo for a national bottling sales and distribution footprint in seven States and five Union Territories for a consideration of ~Rs 18,500 million subject to final adjustments on account of due diligence. Given the growth prospects and promising earning potential, the acquisition comes to a very reasonable valuation which is in line with the Board approved strategic and financial guidelines framed in 2017, and offers an attractive payback. The acquisition will be funded partly through internal accruals, debt and the rest through equity. The Board of Directors will be meeting on 26th February 2019 to consider raising of capital through QIP and exploring various other options presented before them. We expect to close the acquisition by March 2019. The deal is expected to be EPS-accretive in 2020.

To conclude, this has been a strong year for us. We have demonstrated strong cash flow generation, working capital efficiencies and ability to grow and gain market share. We are enthused with our growth prospects as we enter into the new year. We will be focused on concluding the acquisition consolidating and increasing our penetration in the newly acquired territories in the new year. We will remain agile by keeping on top of macroeconomic trends and changes in consumer preferences and adjust our portfolio and processes accordingly offering innovation and choice. We are confident that in the coming years, we will be able to further accelerate the historical trend of strong growth and profit expansion delivered by our business. On this note, I come to an end of the opening remarks and would like to now ask the moderator to open the line for the Q&A. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Vivek Maheshwari from CLSA. Please go ahead.

Vivek Maheshwari: I have quite a few questions on the target asset to the extent you can share. So for CY18, can you give broadly what would be the volume sold, revenues and EBITDA from south and west that the company would have reported if you can?

Raj Gandhi: Volume sold is about 133 million cases in CY18. EBITDA is not available because of the fact that PepsiCo also manufactures and supplies concentrate. Moreover, they have also consolidated Frito-Lays and beverage business. Although, as per the management accounts, they show business is quite robust and end of the day like in the past, and on the calls Chairman has said, whenever there is an opportunity and we acquire and integrate any business, it takes one to two years and then we are able to deliver the same kind of EBITDA that we are making in the existing businesses. We have been proving this time and again over last few decades. Hence, after two years you can assume 18% to 20% EBITDA from the target business. For the current year, of course, we will have to see once we start operations. But to your specific question that in 2018 how much EBITDA or the profit they have earned, that information is not available with us.

Vivek Maheshwari: On 133 million cases, is the mix similar in terms of carbonates versus juices versus…?

Ravi Jaipuria: It is more or less the same. Although, each territory is slightly different than the other, but the gap is not much and we feel going forward in 2019 we should be able to easily blend it to our mix.

Vivek Maheshwari: Second, on the seasonality bit, what you mentioned, can you quantify, May, I think for your current business is roughly around 17% or so, how would it be for south and west, do we have any level of detail at this point?

Ravi Jaipuria: Seasonality in the North and East is 17 – 18%, whereas in South and West it would be 12 - 12.5%. So seasonality wise, new regions are much better and the utilization of manufacturing plants would be much better in the South and West.

Vivek Maheshwari: On the capex, what would be the broad deal size? I saw one of the media interviews where you have mentioned around Rs 1850 crore. Is that broadly the number?

Ravi Jaipuria: That is correct.

Vivek Maheshwari: The board is meeting on 26th. But any thoughts at this moment on debt versus equity?

Ravi Jaipuria: We are looking to fund the transaction with a mix of debt and equity which would be QIP of not more than 5%. We are not planning to dilute anywhere above 5%.

Vivek Maheshwari: Beyond what you are going to pay for acquiring the asset, do you envisage any substantial capex after you acquire the territories, do you have any clarity at this moment?

Ravi Jaipuria: We do not see any major capex in the next couple of years because the capacity utilization around 50% at the moment in the territories which we are acquiring. So unless and until we can grow the business to double the size, I do not think we will look at any major capex, although we would require some capex for the marketing assets which we anyways provide every year.

Vivek Maheshwari: Back-of-the-envelope if I do the calculation based on what your current volumes are, what you are acquiring and all, it looks like in south and west, the market share is lower than what you have in your existing geographies. Is my understanding correct?

Ravi Jaipuria: Your understanding is correct, it is much lower than our average market share. So the headroom for growth is there and we believe low market share is one of the reasons why PepsiCo has given the territory to us.

Moderator: Thank you. The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda: Sir, with this acquisition now, what will be the residual market share with Pepsi, if any, and how will be the market share structured after 80-81%?

Raj Gandhi: 100% of the Pepsi's company-owned bottling operations will come to VBL after this divestment and VBL will account for approx. 83% of PepsiCo's beverage sales volumes in India. However, the balance 17% is with a franchisee in J&K, another in Andhra Pradesh, PepsiCo's joint venture with the Tata called NourishCo where they have 50% equity stake and a small portion of bulk water. So, all these put together, according to us, will be 17-18%.

Pritesh Chheda: So the large bottlers now one in Andhra and one in Jammu?

Raj Gandhi: That is right.

Ravi Jaipuria: There are only two bottlers left; one in Jammu and one in Andhra and both are relatively small bottlers,.

Pritesh Chheda: What is this bulk water? Actually I did not get it.

Ravi Jaipuria: This is the 20-litre jar which goes to homes and offices. That is also included in the liquid refreshment beverage (LRB) category for PepsiCo.

Pritesh Chheda: So that is done by PepsiCo directly?

Ravi Jaipuria: That is being done by co-packers.

Pritesh Chheda: What will be the bulk water share?

Ravi Jaipuria: It should be about 7-8%.

Pritesh Chheda: My second question is between the acquisition from Pepsi that we had done before the IPO and acquisition of market share that we have done now, the difference is that I could spot was the payment terms. I think before the IPO there was a deferred payment if I am not mistaken. Here is there an upfront payment and if so why? Any other differences on acquisition before and after the IPO?

Ravi Jaipuria: Since the market share of PepsiCo is reasonably low in these territories, so the upside is significant and the capacities which PepsiCo has already created are much larger. So we are actually getting this at a favourable price and hence they feel that as they are giving us a reasonably good package and also as we are a public company now with access to capital markets for fund raising, they do not feel that they should give us the option of deferred payment anymore.

Pritesh Chheda: In one of your past calls, you had stressed on the fizzy drink part to remove the seasonality of the business. So, where are we on that journey of the progress?

Ravi Jaipuria: With this new acquisition, our seasonality is going to come down because in South and West region seasonality is much flatter than what it is in the North. So after this year, our overall blended seasonality will come down which is very good and healthy for the business. Also, with Tropicana portfolio coming in, which we did not have earlier, the seasonality curve is going to be marginally flatter going forward.

Pritesh Chheda: How will the region mix change for us with this acquisition, what was it earlier and what will it be now?

Ravi Jaipuria: May is peak month of the year. For us in North, it contributes ~17% of full year volumes whereas in West and South, it is less than 12%, it is a big gap. So, major change is going to be in terms of seasonality.

Raj Gandhi: In the South and West the peak month is April, which in the North is May. So now we will have two peak months, one for the North and East and another will be West and South. Moreover, in Morocco, we have August as the peak month and we have December as the peak in Zimbabwe. So we are trying to balance it in a way that we see continuous cash flow generation.

Pritesh Chheda: In international operations, ex-Zimbabwe, is there a decline or anything because Zimbabwe at 15 million cases on 55 million cases which was last year. So is there a decline in any other markets?

Raj Gandhi: We started our operations at Zimbabwe effective 1st March 2018. For 10-months we had done about 15 million cases and acquired ~ 40% plus market share as against three plants of Coke and one plant of VBL and we have done exceptionally well which no one has replicated ever anywhere.

Pritesh Chheda: So sir, last year it was 55 million cases, your international operations which went to 66, if Zimbabwe added 15, so …

Ravi Jaipuria: Where the gap lies is that we were exporting part of the goods from Zambia to Zimbabwe in 2018. So actually overall internationally we have not declined.

Moderator: Thank you. The next question is from the line of Kaustubh Pawaskar from Sharekhan Limited. Please go ahead.

Kaustubh Pawaskar: Sir, my question is again on the acquisition front. You just mentioned that 133 million cases would be the incremental volumes which you are expecting from the South and West territories which PepsiCo has been getting from the other bottlers. Does it include the volumes of the previously acquired Karnataka and Maharashtra this thing or …?

Ravi Jaipuria: No, this does not include that.

Kaustubh Pawaskar: So how much would the acquisition of Maharashtra, Karnataka territories be contributing?

Ravi Jaipuria: That should be approximately 13-14 million cases.

Kaustubh Pawaskar: So overall we should expect 150 million cases?

Ravi Jaipuria: Approx. 146 million cases.

Kaustubh Pawaskar: The incremental volumes because of the acquisition of parts of Karnataka, Maharashtra territories would be consolidated from Q1 of 2019?

Ravi Jaipuria: A small part of volumes would be in Q1 but full consolidation will happen from Q2.

Kaustubh Pawaskar: South and West region, when should we expect it to consolidate? The deal is expected to be completed by Q2.

Ravi Jaipuria: We expect the revenues to start coming in from April 1st i.e. starting Q2

Kaustubh Pawaskar: My next question is on the penetration part. What is the penetration VBL enjoys in some of the territories which are already matured territories, and what is the penetration level of the recently acquired territories? So that will give us a fair bit of understanding on what is the scope of volumes you will be getting once you are consolidating the territories and once those territories become matured?

Ravi Jaipuria: In the existing territories of VBL we have about 40% market share whereas the new territories which we are just acquiring is about 25%. So there is a clear upside of 15% if we are able to consolidate efficiently and bring these territories to our levels.

Kaustubh Pawaskar: Sir, I am just a bit confused about the volume growth part. You just mentioned that the organic volume growth for 2018 at consol level is 10%, India business volume growth at organic level was 13%. So there is a 3% miss which is because of the international business largely Sri Lanka and Morocco?

Raj Gandhi: That is right. It is basically Sri Lanka because of the sugar tax, as we have mentioned in the earlier calls. We witnessed 30% de-growth in Sri Lanka in CY18. Fortunately, at the year-end that notification for increase in the tax rates called as the sugar tax has been rolled back substantially.

Kaustubh Pawaskar: So, Sri Lanka should stabilize in CY'2019?

Ravi Jaipuria: Sri Lanka has already stabilized for us and we believe we will be on a positive stand in Sri Lanka in CY19.

Kaustubh Pawaskar: Last one on the new product launches. What is the contribution now in the new products especially the low calorie products which you have recently launched to the overall revenues and with Tropicana coming to the portfolio, what is the expectation in terms of contribution going ahead?

Ravi Jaipuria: I think it is a bit too early because we only took over Tropicana in the month of April and we are still not manufacturing the product, we are buying from outside. Our Pathankot plant is coming up, by March-April we will be starting production of Tropicana ourselves and then we expect faster growth in the juice category. But answering your question of our new products, Tropicana portfolio, Pepsi Black (low sugar variant) and Sting (Energy Drink) is about 2% of our mix.

Kaustubh Pawaskar: This Pathankot facility, Rs.400 crore is the capex. This is the only facility which we should consider as the capex for the next year or is there any other facility?

Ravi Jaipuria: That is right, for this year till we stabilize ourselves and get our juice products going in the market properly, this would be the only capex for 2019.

Moderator: Thank you. The next question is from the line of Anand Shah from Axis Capital. Please go ahead.

Anand Shah: Sir, firstly, can you give a breakup of 340 million cases in terms of volumes of India and international for CY'18?

Raj Gandhi: India, we finished 273.6 million cases and 66.4 million cases in international.

Anand Shah: Second, are you disclosing the revenues for both the acquisitions of 133 million cases and 13-14 million cases?

Ravi Jaipuria: We have disclosed the acquisition price and approximate revenue.

Anand Shah: Rs 1,850 crore was for the 133 million cases and the 13-14 million cases for Karnataka, Maharashtra plant that was?

Raj Gandhi: That consideration is being paid in parts. We paid Rs.15 crore initially for the acquisition of the territory and additional ~ Rs. 30 crore for certain marketing assets in that territory. In addition, they have to obtain certain approvals to transfer the lease and once they obtain such approvals for Karnataka plant, we will have to pay about Rs.70-72 crore additionally which will take about 2-3 months. There is another facility at Nagpur and it that will take a couple of years to arrange transfer approvals and we will be buying the same when they have the requisite approvals in place. So till they receive transfer approvals, respective locations will be doing co-packing for us.

Moderator: Thank you. The next question is from the line of Vicky Punjabi from JM Financial. Please go ahead.

Vicky Punjabi: Sir, I just wanted to understand firstly what are the margin levers in this acquisition that will help you kind of drive towards your base business basically from whatever currently to around 18-20%?

Raj Gandhi: Vicky, there are various components for enhancing the margins. One thing which we always have been highlighting is that we are totally backward integrated and that provides about 400-450 basis points incremental margins. The first thing is we will have to backward integrate the total operations in the new territory also. The second is end-to-end dispatches for which we have over 2000 delivery vehicles in our territories in the North and East India. So, we will have to integrate the operations as far as the logistics is concerned. Once we take over the operations, I think gradually with economies of scale and contiguity of territories, I think we shall be coming back to our historical margins.

Vicky Punjabi: But this backward integration, end-to-end dispatches, they will not involve any further capex?

Ravi Jaipuria: It might require some capex. As the third party distribution is expensive, so we might do some capex to support the South and West regions of the country.

Raj Gandhi: I can divide the capex in two parts: The first part we are very clear as far as the production capacity is concerned, which is a major component, we have enough capacity and for another 3-5 years we may not be required to do any capex. As far as the market reach, visi-coolers, trucks or the backward integration capex is concerned, that in any case we will have to keep on reviewing and incurring as and when such situation arises.

Vicky Punjabi: I just wanted to understand on Tropicana. What are the kind of sales we are doing there and how much of the India volumes we will be capturing there?

Ravi Jaipuria: Going forward, all of India volumes will be with us. Up to now we had about 50% of the volume but going forward we will have 100% of the Tropicana volumes which would be from April.

Vicky Punjabi: Sir, how much would that be approximately?

Ravi Jaipuria: We cannot divulge the numbers at the moment, but the only thing I can tell you is Juice is growing at a rapid pace and 100% of Tropicana volumes will be with us.

Vicky Punjabi: Just wanted to understand apart from the acquisitions and the Pathankot plant, what could be the capex number we are looking for 2019?

Ravi Jaipuria: We are not looking for any other major capex going forward for 2019 except some marketing equipment which is visi-coolers. So it will be very small. So 2019 will not be high capex year.

Vicky Punjabi: Sir, going forward, how are we looking at acquisitions now once most of the Indian territories have now been captured?

Ravi Jaipuria: First of all, we need to digest this. It is a large territory which is getting added. We would like to consolidate it, make sure that everything is coordinated properly. So, for one year, I do not think we should look at acquisitions. We first need to consolidate this and make sure that it is funded properly before we will touch anything else.

Vicky Punjabi: Sir, just one more thing was that we have always talked about organic volume growth being in double digits. Would that stand true for South and West as well?

Ravi Jaipuria: As South and West are also part of India. So there is no reason why it should differ.

Moderator: Thank you. The next question is from the line of Anand Shah from Axis Capital. Please go ahead.

Anand Shah: Just on that Rs.125 crore in capex would be for the 13-14 million cases volume in Karnataka and Maharashtra that you would be paying out?

Raj Gandhi: Yes, this is total including the Dharwad plant and payout will be within next three to four months.

Anand Shah: Rs 1,850 crore for the large south and west and the smaller one is about Rs 125 crore in the next two months? I was just asking on the revenue part. The south, west, you said the cases. Any rough estimate you can share in terms of the revenues for both these acquisitions?

Ravi Jaipuria: The revenue is approximately similar to the value we are paying.

Anand Shah: In terms of realization, similar for both of these?

Ravi Jaipuria: Very similar.

Anand Shah: On this domestic, you had a very-very strong quarter, I know it is a seasonally smaller quarter, but still very strong. So this momentum post festive season, are you seeing that sustaining as well?

Ravi Jaipuria: We are seeing reasonably good growth. We have already said that India should be growing in double-digits. But more than that it depends on lot of other factors. So far everything is looking good.

Anand Shah: Because especially the winters have been quite extended this time and have been slightly harsh.

Ravi Jaipuria: These things will happen, one month will be slightly lower, it can be little extra rain or it can be little dry, you cannot really control these things. So there will always be some ups and downs but overall it is looking pretty good and we are quite happy and confident going forward.

Anand Shah: This international you registered 66 million cases here. Again, Sri Lanka is coming back, Zimbabwe is doing quite well and you also added the Nepal plant. So what would be outlook for CY'19 for international?

Ravi Jaipuria: Even internationally we are looking at double-digit growth now. Things are going well. Morocco has picked up for us, Sri Lanka has picked up which were the two laggards for us. Zambia and Zimbabwe are doing extremely well anyway for us.

Anand Shah: The Nepal plant will also start contributing?

Ravi Jaipuria: Nepal has always contributed to growth.

Anand Shah: You had a new plant added?

Ravi Jaipuria: I think all our international territories will be fairing much better this year than they have in the last year.

Anand Shah: Other than the QIP, would you look for other alternative routes. This all will be funded by debt?

Raj Gandhi: That is right.

Moderator: Thank you. The next question is from the line of Rajiv Gupta from RBC Financial Consultants. Please go ahead.

Rajiv Gupta: What is your estimated net debt at the end of calendar '19 assuming 5% dilution through the QIP?

Raj Gandhi: It should be something like Rs. 3,000 crore approximately.

Ravi Jaipuria: Marginally higher to where we are now and even after the acquisition you can say.

Rajiv Gupta: Net debt would not go up?

Ravi Jaipuria: Not substantially for sure.

Rajiv Gupta: Just a back-of-the-envelope calculation, because you would have these numbers. The Pepsi and the non-Pepsi territories which you acquired, would I be right in calculating that the revenue would be in the range of 2,000-2,200 crore as of now based on the numbers of cases you have given?

Ravi Jaipuria: Close to Rs. 2,000 crore.

Rajiv Gupta: If you normalize it at 20% EBITDA, there is…

Ravi Jaipuria: We do not want to say that for the time being and it is not going to happen in the first year. We think we need to first consolidate and take it forward. Going forward, I think both EBITDA and volumes will go up but it will take some time for us to consolidate the territory, it is a large territory.

Rajiv Gupta: What about the kickers which will come in from synergies of contiguous territories and economies of scale?

Ravi Jaipuria: We definitely expect kickers to come in. That is the only way we are going to come to our historical EBITDA levels ultimately. So it is only because of backward integration, contiguous territories, experienced management and volume growth which is going to bring us to this level.

Moderator: Thank you. The next question is from the line of Shalini Gupta from Quantum Securities. Please go ahead.

Shalini Gupta: I just had two questions: One is that you have said that organic volume growth will be around 10-12% for you. Would this growth figure be the same as per the industry or you think you are growing faster?

Ravi Jaipuria: We want to grow faster but we believe industry itself is growing in double digits right now. So we try and do slightly better than that. But it is very difficult to say. We have a very formidable competition.

Shalini Gupta: I had one concern, if you could respond to. India is a diabetic capital and sugar laden drinks would pose a health concern?

Ravi Jaipuria: I think you should look at it both ways. If you have to look at the per capita consumption of this country, on an all India basis maybe two bottles per month and two bottles per month can never bring diabetes to anyone. The problem of sugary drinks is in countries like Mexico and US where they are consuming three to four bottles a day. We are in a situation right now where people are not even getting sugar in most parts of the country. So, we believe that the soft drinks are not going to create diabetes. We cannot be sure about other reasons, sweets and all those things and also people not working, sitting in the chairs and no exercise. Those are more critical reasons, not drinking soft drinks.

Moderator: Thank you. The next question is from the line of Himesh Satra from Joindre Capital. Please go ahead.

Himesh Satra: Could you provide me the segmental sales for the Carbonated Soft Drinks and Non-Carbonated Soft Drinks for CY'2018? I see there is increase in the other expenses as compared to the CY'17. So, could you provide me a clarification for that?

Raj Gandhi: Out of the total volumes, CSD is 257 million cases, juice is 22 million cases, water is 61 million cases. Regarding other expenses, firstly, post-GST introduction, the change is accounting policy for freight i.e. instead of netting off, we have started showing separately which had its impact on the revenue side also and is coming under the other expenses. This year the expense is shown and merged into the freight expenses. So one impact is from that. Secondly, we have done some provisioning for the currency fluctuation in Zimbabwe. So these two line items have increased the other expenses figure. Otherwise everything is in line with previous year.

Moderator: Thank you. The next question is from the line of Sajal Gupta from FE Securities. Please go ahead.

Sajal Gupta: I just wanted to know one thing, the turnover from the new territories which you will be having, do we see a larger growth happening in those new territories?

Ravi Jaipuria: We just said that the market share is lower in those territories. So we are confident that we can do a better job. Maybe our growth will be higher in those territories but it will take some time to consolidate those territories.

Sajal Gupta: What kind of growth do you see from the existing territories right now?

Ravi Jaipuria: We have said that we hope we can grow in double-digits but it has to be seen. Most of the FMCG products in India are growing in double digits. There is no reason why we should not grow. And we witnessed this kind of growth in last year as well.

Sajal Gupta: Correct me if I am wrong, the EBITDA margins what we are seeing in the current year, do you see the drop happening in those margins because of the new territories?

Ravi Jaipuria: We do not expect significant drop happening going forward. Last year, we added Tropicana juices in which we were working practically on no profit basis because we were not manufacturing the product, we were getting these products manufactured by co-packers. So that affected our margins. The new territories in current year will not have the same margin as our existing margins, but overall consolidation will help. Temporarily there could be some pressure but overall in long-term it is looking very positive.

Raj Gandhi: Just to add, even if you see the margins for our existing territory and for existing products during last year have not come down. When you add Tropicana and the new territories, it has come down by 100 plus basis points. But territories which are existing, it has not come down and same is going to happen for the newly acquired territories.

Ravi Jaipuria: So, it takes a little bit of time to consolidate the territory. Hopefully the territories which we have taken in 2018 will get consolidated in 2019 which will help in giving us better EBITDA margins. At the same time, new territory in 2019 will take little bit of toll but I do not think overall it will make much of difference.

Sajal Gupta: You have explained if the EBITDA margins do not fall that will really take the company…?

Ravi Jaipuria: We are not saying it would not fall at all, but it would not be a big impact. Our own manufacturing of Tropicana products will also start. So that will add to margins by middle of the season.

Sajal Gupta: You said that your debt by the year end 2019 would be Rs.3,000 crore. But if right now you have debt of Rs.2,700 crore if I am not wrong?

Ravi Jaipuria: That is right.

Sajal Gupta: By doing the calculation, you will be doing the repayment during the current year to the tune of Rs.400-500 crore?

Raj Gandhi: Yes, the internal accruals for the current year and the QIP proceeds both have been considered while arriving at Rs.3,000 crore.

Sajal Gupta: Your other expenses in the current quarter has gone up to Rs.326 crore…?

Raj Gandhi: As we mentioned we have made a foreign exchange loss provision for the US dollar currency in Zimbabwe.

Sajal Gupta: How much was that?

Raj Gandhi: We have been conservative. It is about US$ 8 million.

Moderator: Thank you. The next question is from the line of Ayush Agarwal from Turtle Wealth Management. Please go ahead.

Ayush Agarwal: In this quarter results in the balance sheet, can you provide me some color on standalone trade receivables related to consolidated trade receivables, like standalone trade receivables it has gone up to Rs.1344 million from Rs.946 million like something around 48% up, so can you provide me some color on debtors for more than six months or less than six months?

Raj Gandhi: If you see trade receivables at the consolidated level, the receivables between Varun Beverages and its subsidiaries gets set off, therefore it is appearing here in the standalone accounts but if you see the consolidated it gets eliminated.

Ayush Agarwal: That is why your consolidated trade receivable is less than your standalone?

Raj Gandhi: It is a receivable by the holdco from its subsidiary.

Moderator: Thank you. The next question is from the line of Bhavesh Shah from CLSA. Please go ahead.

Bhavesh Shah: I just wanted to know with this acquisition, if there is any change in any other terms of your agreement with PepsiCo, be it in terms of concentrate prices or royalty or marketing, any other change which has come with the consolidation?

Ravi Jaipuria: At the moment, the final agreements are being discussed, so it is a bit too early for us to comment. Once the territories are consolidated tentatively from April 1st, we will be able to answer you if there are any changes.

Bhavesh Shah: Can you share any thoughts on input basket for 2019 in terms of prices of sugar and other inputs?

Ravi Jaipuria: Input costs are within the expected limits. So we do not see any major issue coming. We are not talking about couple of points up or down but it will not have a material impact on our overall margins.

Bhavesh: So, if you look purely from your gross margins for CY'19, this should be broadly similar to CY'18 level or should it trend up a bit?

Ravi Jaipuria: Absolutely, it will not come down but I do not see it going up by much.

Moderator: The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda: Just is a question on understanding the total capex and payouts that you will have in the next one year. I was just bit confused. You have the Pathankot capex of Rs.400 crore but in the results presentation you have mentioned that a part of it is already included in the gross debt. So just wanted to know this Pathankot capex is a part of '18 or is it a part of '19?

Raj Gandhi: As for as the capex is concerned, it is for 2019 and in 2018 whatever has been incurred in creating that facility and the debt taken for the same is included in 2018 balance sheet as capital work-in-progress as a separate line item.

Pritesh Chheda: So you have already spent about Rs.350 crore on Pathankot is what reflects on CWIP?

Raj Gandhi: Exactly.

Pritesh Chheda: Which means Pathankot for CY'19 will be just Rs.50 crore incremental that you have to spend?

Raj Gandhi: No; in fact, Rs.400 crore debt we have already taken, the capex maybe to the tune of Rs.550 crore overall and we will have to incur the balance about Rs.150 crore during the current year.

Pritesh Chheda: So Rs.150 crore in Pathankot in '19. What will be the maintenance capex?

Ravi Jaipuria: Maintenance capex does not come in capex. We directly charge it to P&L.

Pritesh Chheda: So you just have one capex of Rs.150 crore of Pathankot.

Ravi Jaipuria: That is the main CAPEX, plus some marketing equipment's, which we put every year, which is visi-coolers, glass bottles, etc.

Pritesh Chheda: What would be that amount?

Ravi Jaipuria: That normally is about Rs.100 crore.

Pritesh Chheda: Rs.1,850 crore for this acquisition and there is one deferred payment for your past acquisition, the 13 million case. So what is that amount?

Raj Gandhi: We have paid for that territory (13 million case). The only thing is when the manufacturing plant comes, about Rs.70 crore at that point of time we will have to make additional payment.

Pritesh Chheda: Considering all this, with the cash flow that you get in CY'19, you estimate that the year-end debt will be Rs 3,000 crore assuming 5% is dilution?

Raj Gandhi: This is our back-of-the-envelope calculation.

Ravi Jaipuria: It will be very close, it could vary by Rs.50-100 crore less or more depending on how the season goes.

Pritesh Chheda: When we look at the margins, obviously for the last 2 or 3 years also we have one or the other acquisition, so I just wanted to know in our existing territories, what kind of best-case margin that you have seen or I will ask the question other way, in this business operations, what kind of margin potential is possible?

Ravi Jaipuria: Potentially, the margin in the consolidated territory should come back to what we are showing in existing territories. If you look at the last few years, we have been consolidating, and our overall margins have not come down by much. But, as this is a larger acquisition, initially, the margin would not be the same and that is why we expect some pressure on margins. In the existing territories, the margins should remain the same or be slightly better only.

Pritesh Chheda: What headroom do you have in terms of margin?

Ravi Jaipuria: There is not much headroom in existing territories. We are already pretty much at higher level of margins compared to our global peers. The only headroom is by growing the volumes, we will get extra margins in absolute terms, but not in percentage terms.

Pritesh Chheda: There was one conversation in the past call that GST would help you gain benefit on margin?

Ravi Jaipuria: That has already happened. GST has been on the full year.

Pritesh Shah: On transportation side, so all that has already been taken?

Ravi Jaipuria: All that has been included and taken into account.

Moderator: Thank you. The next question is from the line of Anuj Sehgal from Manas Capital. Please go ahead.

Anuj Sehgal: For 2018, what was the organic volume growth for carbonated drinks, juice and water separately and what is your expectation for the same in 2019?

Ravi Jaipuria: For CSD, which is carbonated beverages was 17%, juice was 59.5% and water was 35%.

Anuj Sehgal: But this is not the organic volume growth right?

Ravi Jaipuria: Organic growth was 8.2% for carbonated beverages, 43% for juice and 24% for water.

Anuj Sehgal: What would be your expectation, you mentioned double digit volume growth for 2019, how would it break by these three segments?

Ravi Jaipuria: That would be very close to what we have done in 2018. We are trying to grow in double digits in our core business which is CSD, that is what our target is.

Moderator: Thank you. The next question is from the line of Rajiv Gupta form RBC Financial Consultants. Please go ahead.

Rajiv Gupta: Would you throw some light on this $8 to $9 million provision? The logic is it is just conservative accounting. Which quarter did you provide for this?

Ravi Jaipuria: We have provided this in the 4th quarter.

Raj Gandhi: Basically, what happens is the currency in Zimbabwe is little volatile and availability becomes a challenge. As per our auditors, if we have to remit that money from there, we may not get that equivalent money and hence the provision is created.

Ravi Jaipuria: We have taken conservative measures.

Rajiv Gupta: It is a large amount; it is about Rs 56 crore and it is not mark-to-mark loss, it is just conservative accounting.

Raj Gandhi: It is not accrued; it is a provision.

Rajiv Gupta: That is very substantial. It makes a material difference to this quarter's results?

Ravi Jaipuria: That is right.

Moderator: Thank you. The next question is from the line of Sajal Gupta from FE Securities. Please go ahead.

Sajal Gupta: Can you please give a country wise volume and the profits which you are accruing on consolidated basis?

Raj Gandhi: We can give you for India and overseas which are published. Country-wise, if you need, offline maybe you can connect with our office.

Sajal Gupta: I was asking if you could comment on the presentation itself, so there is data to look at, how each country is doing.

Ravi Jaipuria: We will evaluate it, and if possible, try and do it next time.

Moderator: That was the last question. I now hand the conference over to the management for their closing comments.

Raj Gandhi: Thank you once again for your interest and support. We will continue to stay engaged. Please be in touch with our investor relations team for any further details or discussions. Look forward to interacting with you soon. Thank you very much.

Moderator: Thank you. Ladies and gentlemen, on behalf of Varun Beverages Limited, that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.
